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Supreme Court, U.S.
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No. 05-1429

IN THE

Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Petitioner,

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF

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REPLY BRIEF FOR PETITIONER

Adhering to its prior precedent, the Ninth Circuit disposed of Travelers' claim for attorneys' fees through the application of a single rule of law that it first created over a decade ago: "attorneys fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'" Pet. App. 3a (quoting *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149, 1153 (9th Cir. 1991)). The Ninth Circuit neither addressed nor resolved any other issue in disposing of Travelers' claim and, accordingly, no other issue is presented to this Court for review.

In its petition, Travelers demonstrated that three other courts of appeals apply the *Fobian* rule and deny claims for attorneys' fees incurred in litigating bankruptcy issues, and that five other courts of appeals follow a contrary rule and allow such claims. This conflict is immediately apparent from the *holdings* of the decisions of these courts, as well as by analysis of their reasoning. In its opposition, Respondent PG&E says nothing at all about the conflicting holdings of the courts of appeals on the question presented. Instead, PG&E -- inartfully and unsuccessfully -- attempts to evade the issue by interposing a series of irrelevant distractions. Because a longstanding, entrenched, and widespread conflict exists among the courts of appeals on the question presented in this case, certiorari is warranted.

Travelers also demonstrated in its petition that the decision of the court below conflicts with prior precedents of this Court. First, it conflicts with this Court's prior precedents holding that the question whether a creditor is entitled by contract or statute to recover attorneys' fees for litigating issues in bankruptcy is a matter of state law. Second, it conflicts with prior precedents of this Court restricting the ability of federal courts to create federal common law rules that preempt state law rights. Third, it conflicts with this Court's prior precedents restricting the ability of federal courts to create categorical restrictions on claims in bankruptcy cases. PG&E offers nothing in response. Because the decision of the court below conflicts with prior precedents of this Court, certiorari is warranted.

Contrary to PG&E's contentions, the question presented is important and hardly arcane. The Ninth Circuit has applied its *Fobian* rule repeatedly, as have three other courts of appeals. In contrast, five courts of appeals apply a contrary rule, creating discord in the administration of bankruptcy proceedings on a national basis. This case presents an ideal vehicle to resolve the conflict because the Ninth Circuit resolved Travelers' claim purely as a matter of law through application of its *Fobian* rule. Moreover, this Court would not be required, as PG&E suggests, to consider any other issue (including any purported dispute over the interpretation of Travelers' contract) because the court below neither addressed nor resolved any other issue. *See Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 168-69 (2004) ("'We ordinarily do not decide in the first instance issues not decided below.'") (quoting *Adarand Constr., Inc. v. Minetta*, 534 U.S. 103, 109 (2001)).

Finally, the decision of the Ninth Circuit in this case is simply wrong, and Travelers is entitled to its fees incurred in, among other things, defending against PG&E's aggressive and unnecessary litigation. PG&E's various contentions to the effect that Travelers was "unsuccessful," holds a "meritless" claim, and "meddled" in PG&E bankruptcy case, are unfounded. After bringing suit against Travelers, PG&E executed a settlement agreement with Travelers that successfully preserved the substance of Travelers' rights and claims, *and in that very same settlement agreement* acknowledged that Travelers could assert a claim for its attorneys' fees under its contract (subject to PG&E's right to object to Travelers' fee claim). Each of the courts below denied Travelers' claim *only* as a matter of law on the basis of the *Fobian* rule. Because the *Fobian* rule is invalid, this Court should grant certiorari and reverse the decision below.

A. The Courts Of Appeals Are Divided Over The Question Presented.

In the companion case *DeRoche v. Arizona Indus. Comm'n*, no. 05-1439, respondent State of Arizona candidly concedes that the courts of appeals are deeply divided on the question whether a litigant may recover attorneys' fees under a contract where the

issues litigated involve matters of federal bankruptcy law. *DeRoche* Pet. Opp. 11. In discussing this split, the State accurately summarizes the *holdings* of the decisions of the courts of appeals that have allowed attorneys' fees, in conflict with the decisions of the Ninth Circuit, and cites to the leading treatise on bankruptcy law that explains and analyzes the conflict. Pet. Op. 11-12.

In the instant case, respondent PG&E does not refute Travelers' demonstration of the existence of a circuit split on the question presented. Instead, it argues -- disingenuously, based upon completely irrelevant reasons -- that no conflict among the courts of appeals exists. These arguments are unavailing.

First, PG&E asserts that the kind of contract at issue in this case (a surety's indemnity contract) is not precisely the same as the kind of contract at issue in the other cases (e.g., a landlord's indemnity contract). PG&E does not explain, however, why this difference is relevant; nor could it, as no reason exists. PG&E does not deny that, in *Fobian*, the Ninth Circuit created a rule of general federal common law that a litigant may not recover attorneys' fees under a contract where the issues litigated involve matters of federal bankruptcy law. PG&E also does not deny that the Ninth Circuit has repeatedly applied its *Fobian* rule to cover all kinds of contractual rights to attorneys' fees. Far from unique, this case is typical of what has become the Ninth Circuit's routine application of its *Fobian* rule. That Travelers is a surety, or that its contract is a surety contract, is of no moment.

Second, PG&E argues that Travelers is not entitled to prevail for "unique" reasons peculiar to the facts of this case. Specifically, PG&E contends that notwithstanding that it reneged on its negotiated deal with Travelers regarding the treatment of Travelers' rights, and then affirmatively *sued* Travelers in the bankruptcy court to eliminate Travelers' rights as a surety, Travelers' $100 million bond and associated rights were never in jeopardy during PG&E's bankruptcy case and that Travelers' claim for attorneys' fees is therefore unreasonable. PG&E also argues that its own assertions concerning Travelers' status in the bankruptcy proceedings and the reasonableness of the fee amount distinguish the Ninth Circuit's decision in this case from the

decisions of other courts of appeals. This is nonsense. None of the courts below based their denial of Travelers' claim for attorneys' fees on these grounds. To the contrary, each of the courts below simply applied the *Fobian* rule that, as a matter of law, a litigant is not entitled to recover attorneys' fees if the issues litigated involve questions of federal bankruptcy law. Accordingly, PG&E's assertions are irrelevant to the holding of the courts below, and to the conflict among the courts of appeals.

Third, PG&E attempts to disguise the conflict among the courts of appeals by simply ignoring the actual disagreement over the question presented and focusing on a series of irrelevant issues. To begin with, the fact that courts typically agree that there is no general right to attorneys' fees, Pet. Op. 14, is beside the point. The question is what is to be done with a right to attorneys' fees that arises under a contract or statute.

That courts typically agree that a litigant may recover a contractual or statutory right to attorneys' fees incurred in litigating *state* law issues, Pet. Op. 15, also is beside the point. The question presented -- and the point of the *Fobian* rule -- is what is to be done with attorneys' fees incurred in litigating *federal* bankruptcy issues.

That courts may disagree on whether a particular dispute over a debtor's discharge is encompassed within the scope of a litigant's contractual right to attorneys' fees, Pet. Op. 15, is equally beside the point. The question presented -- and the subject of the circuit split set forth in Travelers' petition -- is whether the *Fobian* rule is valid or invalid. That courts may further disagree on the application of the *Fobian* rule in the discharge context does not eliminate the larger split on the essential legitimacy of the *Fobian* rule itself.

Furthermore, while it may be difficult, for purposes of calculating and awarding fees, to distinguish between the litigation of state and federal issues in some cases because the issues may be intertwined, Pet. Op. 18, this suggests only that the *Fobian* rule is complex and cumbersome. Again, this difficulty does not render nonexistent the conflict among the courts of appeals on the legitimacy of the *Fobian* rule. Nor is the observation relevant in

this case, as the Ninth Circuit denied the *entire amount* of Travelers' fees on the ground that *all* the issues litigated were federal bankruptcy issues.

Contrary to PG&E's contention that Travelers has mischaracterized the *Fobian* rule, Pet. Op. 16, Travelers has simply presented the rule as the Ninth Circuit had stated and applied it. In this case, the Ninth Circuit, quoting *Fobian*, stated the rule as follows: "attorneys fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'" Pet. App. 3a (quoting *Fobian*). And as PG&E *concedes*, Pet. Op. 17, other courts of appeals allow the recovery of attorneys' fees for litigating bankruptcy issues. Thus, comparing the Ninth Circuit's statement of its own rule with PG&E's concession is itself sufficient to demonstrate the conflict among the courts of appeals concerning the question presented. The "problem" is not Travelers' characterization of the *Fobian* rule but PG&E's disingenuous efforts to evade the existence of the conflict.

Finally, contrary to PG&E's assertion, Pet. Op. 19, Travelers has not mischaracterized the cases that reject the *Fobian* rule. For example, PG&E argues that the Fourth Circuit's decision in *Three Sisters Partners LLC v. Harden (In re Shangra-La, Inc.)*, 167 F.3d 843 (4th Cir. 1999) demonstrates *uniformity* among the courts of appeals. PG&E is wrong. The very proposition that PG&E contends *Shangra-La* stands for actually demonstrates the divergence of opinion among the courts of appeals and the need for guidance from this Court.

In *Shangra-La*, the debtor had defaulted on a commercial real estate lease prior to filing for bankruptcy. 167 F.3d at 845-46. The lease provided that the landlord could collect legal fees incurred in enforcing the lease, under certain circumstances. *Id.* After the debtor filed for bankruptcy, the landlord "actively participated in the case." *Id.* at 846. The landlord objected to relief sought by the debtor's trustee under the bankruptcy code, objected to plans of reorganization proposed by others, and even filed its own proposed plan of reorganization for the debtor's business. *Id.* at 846-47. The landlord also objected to motions seeking to extend the time for the debtor to assume or reject its lease under a specific

provision of the Bankruptcy Code, and sought relief from the automatic stay provided to the debtor by the bankruptcy code. *Id.*

Eventually, the debtor's trustee "assumed" the lease, and was required to cure all defaults. 167 F.3d at 847. As a result, the landlord sought reimbursement of its legal fees involved in its pre and post-petition litigation with the debtor. *Id.* The bankruptcy court allowed the landlord to recover its pre-petition fees, but denied the request for post-petition fees because such fees were incurred "litigat[ing] issues particular to bankruptcy law." *Id.*

On appeal, the Fourth Circuit reversed and remanded. 167 F.3d at 852. The court focused on the bankruptcy court's denial of fees relating to bankruptcy-specific matters, such as the landlord's "participation in the plan confirmation process," and attempts to obtain relief from the automatic stay. *Id.* at 848. The court concluded that the simple question whether bankruptcy issues were involved was irrelevant, *id.*, and that what was relevant was whether the fees incurred during the bankruptcy case were within the scope of the underlying contract (there, the lease), *id.* at 850.

Here, the Ninth Circuit came to the exact opposite conclusion: if bankruptcy issues are involved, the terms of the underlying contract are irrelevant. Pet. App. 9a, 25a. The differences between the approach taken by the Fourth Circuit in *Shangra-La* and by the Ninth Circuit in this case demonstrate the presence of a clear conflict among the courts of appeals. The rule applied by the Fourth Circuit employs the proper analysis and focuses on the underlying state law contract rights agreed upon by the parties. The rule of law applied by the Ninth Circuit, on the other hand, is an impermissibly created and inappropriate federal common law rule.

The decisions of the courts of appeals clearly conflict on the question presented. Accordingly, certiorari is warranted.

B. The Decision Below Conflicts With Prior Precedents Of This Court.

As explained in the petition, Travelers right to attorneys' fees falls within the broad scope of its indemnity agreements and is valid under California law. Under section 101 of the Bankruptcy

Code, a contractual right to attorneys' fees that is valid under state law unquestionably constitutes a "claim" for bankruptcy purposes, irrespective of whether the claimant incurred the fees before or after the debtor commenced its bankruptcy case. 11 U.S.C. § 101(5); *Cohen v. De La Cruz*, 523 U.S. 213, 228 (1998). In turn, under section 502(b) of the Code, a valid state law claim must be allowed in the debtor's case unless a specific provision of the Code disallows it. 11 U.S.C. § 502(b); *Raleigh v. Illinois Dep't of Revenue*, 530 U.S. 15, 20 (1990). Because no provision of the Bankruptcy Code disallows a contractual claim for attorneys' fees on the ground that the fees were incurred in litigating federal issues -- and given that federal courts lack the authority to create novel rules governing the categorical treatment of claims in bankruptcy, *see United States v. Noland*, 517 U.S. 535, 540 (1996) -- claims for attorneys' fees must be allowed if valid under state law. Accordingly, the Ninth Circuit's *Fobian* rule, relied upon in the decision below (as well as in the decisions of other circuit courts of appeals), is in error. Under the correct analysis, the question is not whether federal law authorizes the claim, but rather whether bankruptcy law extinguishes the state law right by disallowing the claim, which it does not in this instance. *Security Mortgage Co. v. Powers*, 278 U.S. 149, 154 (1928).

In response to Travelers' demonstration that the decision of the Ninth Circuit in this case conflicts with this framework and prior precedents of this Court, PG&E has essentially nothing to say. It does not refute that Travelers' contractual right to attorneys' fees constitutes a "claim" for bankruptcy purposes; nor does it dispute Travelers' explication of how "claims" are to be treated in bankruptcy. Further, PG&E does not contend that any provision of the Bankruptcy Code disallows Travelers' claim for attorneys' fees. Instead, PG&E merely assumes that courts should have the power to deny claims for attorneys' fees, but never bothers to explain where this authority comes from.

In an effort to obscure the issue, PG&E again recites a litany of criticisms against Travelers. These criticisms are both completely irrelevant and meritless. Travelers never "stipulated" or "admitted" that the claim it filed in PG&E's bankruptcy case was

meritless, as PG&E contends. Pet. Op. 26. Precisely to the contrary, Travelers argued throughout that its claim was warranted and the parties' entered into a settlement agreement that preserved Travelers' rights. Nor was Travelers' financial position "unimpaired" by PG&E's bankruptcy filing, as PG&E claims *Id.* In fact, Travelers' financial position did not become unimpaired until *after* it negotiated its treatment under PG&E's plan of reorganization and settled the litigation that PG&E brought against it. And, contrary to PG&E's assertion, Travelers *did* prevail on numerous legal points, and the parties settled the remaining disputed issues. Thus, Travelers pressed successfully for the protection of its future rights, as well as those of the injured employees covered by its bond. Ultimately, Travelers incurred the bulk of its attorneys' fees responding to PG&E's pointless suit against Travelers, in which PG&E sought unsuccessfully to eliminate Travelers' rights associated with its $100 million bond. Travelers is entitled to its claim for attorneys' fees, and PG&E cannot justify the *Fobian* rule indirectly by criticizing Travelers.

The decision below conflicts with prior precedent of this Court. Accordingly, certiorari is warranted.

C. Respondent Mischaracterizes The Issue Before The Court.

PG&E opposes certiorari on the ground that the petition "includes a thorny, fact-bound contractual issue" concerning whether Travelers' claim for its fees falls within the scope of its indemnity agreements. Opp. Br. 24. This contention is meritless. It is abundantly clear that the courts below ruled on Travelers' claim for attorneys' fees *as a matter of law* and never reached any other question, including whether Travelers' fees fall within the scope of its contract. Pet. App. 9a, 25a. PG&E's contrary assertion constitutes a transparent attempt to obfuscate the pure question of law decided by the courts below and presented in Travelers' petition.

Nor could the Court face any "thorny fact-bound issue" of contract interpretation if certiorari is granted because none of the courts below decided this issue. *See Cooper Indus., Inc.*, 543 U.S. at 168-69 ("'We ordinarily do not decide in the first

instance issues not decided below.'") (quoting *Adarand Constr., Inc.*, 534 U.S. at 109). In addition, the issue is not part of the question presented. *See Glover v. United States*, 531 U.S. 198, 205 (2001) ("[W]e do not decide issues outside the questions presented by the petition for certiorari."). Finally, PG&E would not be entitled to "smuggle in" the issue. *See Izumi Seimitsu Kogyo Kabushiki Kaisha v. U.S. Philips Corp.*, 510 U.S. 27, 34 (1994) ("[W]e continue to strongly 'disapprove the practice of smuggling additional questions into a case after we grant certiorari.'") (quoting *Irvine v. California*, 347 U.S. 128, 129 (1954)) (plurality opinion).

CONCLUSION

For the foregoing reasons, the Court should grant the petition for writ of certiorari. Alternatively, Petitioner requests summary reversal.

Respectfully submitted,

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